director, chief tax officer for XO Communications. I just like to start by saying I'm not an attorney. My background is more in the finance area; more specifically, in the tax and the accounting fields.

XO is one of a dwindling number of facilities-based competitive carriers that provides a full suite of telecommunications and information data services. We are also the largest holder of LMDS spectra. Our customer base is the multi-line business customer market.

For XO, at this particular point, every dollar counts as we continue to struggle to continue to compete. While we also firmly believe that the USF is extremely important, and we are, of course, willing to contribute our fair share to the program, we strongly urge the Commission to keep in mind companies like ours as you work to revamp the program.

XO has to be able to control back office costs if we are going to be able to survive. A regulatory mandate that forces XO to rebuild our billing systems would be extremely burdensome for the company and for other small telecos.

For this reason, XO urges you to continue to provide us with complete flexibility regarding how we collect the USF from our customers. In addition, XO needs to be able to continue to collect a small percentage above the assessment amount to account for administrative costs of the program.

XO has never treated the USF collection as a money maker. In fact, the company, historically, has paid out more than it has collected from our customers over time. We'd be happy to see a safe harbor established for this purpose.

The proposed connection-based system for determining carrier contributions would impose large burdens and expense to our back office support functions. We believe this would be true for all small- to medium-size carriers. This burden becomes even more substantial if the Commission elects to go with a monthly filing frequency.

The company currently maintains electronic systems to track and record revenue for the federal and state regulatory fees that are based as a percentage of revenue. The system was used to build in federal and state telecommunications sales and excise taxes.

XO also maintains a manual system for complying with various line-based regulatory fees that have been implemented by some state and regulatory authorities. These fees include the local 911 service charges often assessed on a per line basis.

Based on our review of the MPRM, the proposed connection-based system is substantially different from all of the existing structures, and would require the company and maintain an additional reporting mechanism for purposes of the connection-based system.

We believe that it would be similarly burdensome and costly for XO to revamp its entire end user billing system if we are required to pass through a universal service cost in a manner consistent with a connection-based assessment system. This cost would be a significant portion of our 2003 IS development dollars.

To give you an example, just to talk a little bit historically about the company, the company has ruled out products over time. As we do that, we write these offer codes and billing codes for each new product.

We estimate that we had to convert to a connection-based billing system for the USF, our Information Services Department would have to review or rewrite more than 100,000 separate existing billing codes. Based on our initial discussions with the IT teams, this would be an extremely costly process for XO.

Again, XO is in a position in its life cycle where we're doing everything we can to minimize the cost of our back office support functions. And again, we have infrastructure in place to report and recover, based on a revenue approach.

We have to have this. We have to have this in place now to comply with our tax obligations -- our federal and state tax obligations -- and we've had this for years. That is, in fact, how we currently manage the existing USF requirements.

We view the new recovery structure would likely be extremely complex to administer because customers routinely add, drop, and change services that would continue to effect the universal service connection-based contribution attributable to a particular customers.

Each time the customer adds or deletes a charge on a multi-line product, the corresponding universal service codes in the customer records would have to be adjusted. Again, more back office support functions, and we believe this would be done within a very manual format for us.

The other concerns we have -- a connection-based approach, coupled with the base factor that frequently changes, is likely to lead to greater customer confusion. Our customers are multi-line business customers. Our sales force is often asked, and we are often asked to support the sales force in this, what the bottom line bill is going to be for a lot of these multi-line businesses.

In order to provide them with that information, we need to know what the tax functions are going to be, the regulatory fees and obviously, the big component of that is the federal USF. We would encourage some type of stability and consistency in any mandated recovery process.

Another issue we believe exist is a connection-based would also discourage the installation of redundant and reserve capacity that a customer may need in the future. This would reduce the overall network security we believe at time when having a secure, redundant network is extremely important.

It is also extremely complex to figure out how to bill a customer that has purchased some of our newer products based on what we call "burstible capacity" where additional capacity is available during peak periods of demand.

A connection-based approach may also cause customers to base product selection in an effort to avoid additional USF charges rather than sizing their capacity in present and future needs. A revenue-based approach does not have this same effect.

To summarize, for all of these reasons, I urge you to keep in mind that the smaller telecommunications companies -- keep the smaller telecommunications companies in mind as you refer with these. Giving companies like XO the flexibility to decide how to collect the USF from the customer is a critical cost issue for use.

While some of the other large carriers may be comfortable that they can revamp their systems, these costs are a much greater percentage of our IT dollars. We cannot afford to be saddled with an additional requirement that requires us to build or rebuild our back office support functions at this time. Thank you again for allowing me to speak.

MS. ABERNATHY: Thank you very much, Mr. Ednie.

Now we move on to Mr. Sheard? I hope I said that right?

MR. SHEARD: Yes. I would like to also thank you for providing the opportunity to share my opinions and observations as well as to hear first-hand the opinions and observations of everybody else about this topic that is vitally tied to ensuring the continuing availability of affordable and reliable telecommunications services to so many Americans.

I work for a company called Montana Independent Telecommunications Systems or MITS. I-Connect Montana is a division of MITS that builds and operates data centers in Montana.

We represent independent and cooperative telecos that provide a variety of services to customers who happen to live and work in the very remote parts of the United States. We also serve some extremely economically-depressed areas.

These companies provide, not only basic services supported by the federal universal service mechanisms, but also non-supported local and long distance, wire line and wireless services as well as dial-up and dedicated internet access, including DSL services to nearly 150 communities with populations under 2000.

These companies have also joined together to ensure the availability and affordability of services such as sonic transport, interactive video conferencing and data center services.

Montana's rural teleco has been providing high quality services in rural Montana and parts of Wyoming and North Dakota since the late '40s. Our customers rely on us to ensure that the services that they receive are comparable in price and functionality to those enjoyed subscribers in urban areas.

We, in turn, have relied for decades on the support mechanisms, such as federal universal service high cost fund, to enable us to provide access to basic local service. Due to the high cost nature and the low customer densities of our service areas, absent the federal support mechanisms, telecommunication services would certainly not be available at affordable rates in many areas and in other areas would simply be unavailable.

I would like to make a few general comments about the assessment and contribution methods. At this time, we do not support any of the contribution-based assessment mechanisms. We feel that the current revenue-based system works very effectively in an equitable, competitively neutral and generally, non-discriminatory manner.

We don't believe there has been any clear and convincing evidence presented that the current system should be replaced or that any replacement mechanism would be more sustainable over time, or for that matter, more equitable, non-discriminatory and competitively neutral or even less administratively burdensome.

While we're concerned about the apparent decline in the inter-exchange carrier revenue and the funding base for the mechanisms, we don't believe it justifies the abandonment of the current assessment mechanism.

Also, the Commission adopted the current revenue-based contribution mechanism in the first place because after a thorough, comprehensive analysis, it was determined that the mechanism best met the goals and policies expressed in the Act, and there is no reason to change that conclusion.

There have been some concerns expressed over the growth of the fund. However, with decisions to move cost recovery out of access, increases in the federal fund were inevitable and should come as no surprise.

We do agree that the Commission should consider modifications to the current mechanism where necessary. The current system has already undergone several revisions and improvements as its evolved over time. We believe that this is a good path to continue on.

For example, several commentors have already addressed how to try to fix the time lag issue. They've brought up the CMR safe harbor issue, et cetera. We also support the Commission's examination of broadening the USF revenue assessment base by including interstate revenues from entities such as ISPs, and that also gets to the DSL cable disparity issue.

The contribution scheme should not overburden the very customers the system is designed to help. We feel that implementation of the connection-based system would exacerbate billing impacts from other changes that are going on, such as slick increases in the imposition of other end user charges like number portability, 911, state excise tax, surcharges, et cetera.

Also, although the connection-based funding proposals would largely allow ISCs to escape USF funding responsibility, end users would essentially experience local rate increases with no certainty that the ISCs would flow through their savings to toll rates; especially, to the rates available in rural areas like Montana where not all discount toll plans are available.

A few quick comments on the recovery mechanisms of the contribution. We believe the Commission should take actions that would restrict carriers ability to make end profit on their recovery methods, and I'm referring to the evidence presented by several parties that ISC toll line surcharges is purported designed to recovery USF contributions that ranged much higher than the assessment factors.

The Commission could possibly establish a safe harbor that would allow carriers who chose to do so, and use line item surcharges to recover the contributions; plus, perhaps, a specified margin for uncollectible, but no more. Carriers who chose to utilize line item surcharges higher than the safe harbor amount should have to provide documentation to support the higher level.

We also believe it's appropriate for the Commission to require clear labeling of any line items designed to recovery USF contributions, and we do not think that life line customers should be charged any amounts for USF contribution recovery. Thank you.

MS. ABERNATHY: Thank you very much.

Mr. Travieso?

MR. TRAVIESO: Thank you very much, Madame Chair, and members of the Joint Board.

I'm Michael Travieso. I'm on the Maryland

People's Council; but I'm here today on behalf of NASUCA, which is a national organization of state utility consumer advocates from 42 states, and I think the District of Columbia. Thank you very much for the invitation, and we appreciate the opportunity.

I would refer you to the comments that we filed in writing. We filed three sets of comments and an ex parte so far in this proceeding.

The Commission should retain a revenue-based assessment system and not use a connection-based mechanism. Such a system would permit some IACs to avoid paying anything into the USF, and would raise the bills of 40 percent of residential customers that make the least use of interstate services.

There are actually, we estimate, 25 percent of consumers who make no long distance calls at all. So I would differ a little bit with Bill Gillis in his statements. It seems to me that it is inequitable to shift the burden to consumers who make little or no use of interstate services and to lower the rates of high-use consumers by somewhere in the 5 to $6 range, which we think this connection-based proposal would do.

The cause of the Commission's concern should be the growth and the size of the fund, which seems to have tripled in the last three years and is like to continue to grow or double, I guess.

We look at the interstate minutes and total interstate minutes are going up. Total revenues from interstate services are going up, and I would refer to you to your own report -- Telephone Industry Revenues issued January 2002 -- which shows an increase from $94 million to $119 million in total interstate revenues. So there is money there. It is just a question of assessing -- broadening the base of assessments.

Now on the way to recover from consumers, we have an eloquent, simple and completely non-discriminatory system for assessing consumers, which avoids all the problems that have been discussed through the day, and that is, to prohibit surcharges on consumers. If you did that, you would solve all of your problems.

There are many problems with surcharges. From a consumer's prospective, surcharges and line items hide the true price of services. For example, services are advertised at 7 cents a minute, but if you factor in the 12 percent USF surcharge, the rate is really 8 cents a minute. So consumers are not getting the true price signals.

Surcharges and line items inhibit comparison shopping for similar reasons. Surcharges and line items are inconsistent with the FCC's policies of truthful advertising. Consumers cannot make informed decisions if they don't know what the true per minute rates are and what the true USF surcharges are going to be. They insulate costs from competition.

I think this is an important point. If consumers pay 6 cents per minute -- if the company pays 6 cents per minute, but the consumer pays 11 cents per minute, based on the mark up, then the extra nickel is not subject to competition because it becomes part of a regulated surcharge.

Nobody is looking at those mark ups. Nobody is discovering whether there is any cost basis for those mark ups. There is absolutely no incentive for carriers to compete to have a lower or more efficient mark up because they are assured collection.

For that reason, surcharges favor less efficient carriers. Surcharges can increase the overall rates. They act as a cover, for example, for other cost increases because the surcharge can be marked up to cover those cost increases and shield the company from competition. They actually can cost subsidize the actual business that these carriers are doing.

Eliminating surcharges eliminates concerns that some carriers are overstating costs and no real recovery in assessments. That's the same point I just made.

The state prohibited and USF surcharges --

Georgia, for example, has a state statute that prohibits carriers from recovering by means of surcharge. They are state USF contributions.

We believe the Commission has the legal authority to prohibit surcharges. We would refer you to the Commission's Truth in Billing Order, which discusses the scope of your authority in this area. Also, if the Commission can mandate a line item fixed fee surcharge, it seems like it ought to be able to prohibit surcharges altogether.

Finally, even if the Commission does not eliminate surcharges, you should certainly eliminate any mark up from USF contributions, and it's for the reasons that I've said. They should be only able to recover the dollar-for-dollar contributions and not mark these up.

They can recover whatever legitimate expenses they have under our proposal and the cost of doing business. They do have control. It's not an uncontrollable item because almost 50 percent of that cost now constitute mark ups, and that's over $2 billion a year that consumers are paying just for the mark ups. Thank you.

MS. ABERNATHY: Thank you, Mr. Travieso.

Mr. Blaszak?

MR. BLASZAK: Thank you, Commissioner Abernathy.

My name is Jim Blaszak. I'm here today

representing the Adhoc Telecommunications Users Committee. Business users, the folks who have supported universal service for decades.

As one of my partners put it, we're the people with the bull's eye on our chests. The Adhoc Committee has been active in the universal service docket from its inception in 1978. The Committee fully supports the universal service, but the current system is fatally flawed. It is not substantiable and it is inequitable.

Accordingly, the Adhoc Committee supports the COSAS' proposal and is part of COSAS. The Adhoc Committee, however, differs with the carrier members of COSAS on an important issue. An issue on which we have agreed to disagree. That's the issue of mark up.

The Adhoc Committee believes that the universal service fund charges flowed through to end users by carriers should not, in effect, be turned into a vehicle for cross-subsidization of other carrier activities or enhanced carrier profitability.

Now the temptation might be to think of the mark up as not a problem because, after all, these charges come from long distance carriers. And after all, isn't that market ineffectively a competitive market?

I submit that there has been a market failure. A market failure results with respect to the long distance carriers. It results from the Commission's 1997 report and order in which it authorized the long distance carriers to unilaterally reform contracts to change fixed rates. The only way they could do that without violating contracts was to impose a surcharge.

In effect, sanctioned by the regulatory authorities, and because they were then tariffing and had since subsequently been required to post all of their prices on their internet sites. They all knew what each other were charging. Well, what are they charging? They are charging at least 45 cents more -- that is, 45 percent -- 45 percent more than the Commission assessment rate. Those are big numbers ladies and gentlemen.

Well, if you think they are big numbers, and there has been a market failure when they're imposed by long distance carriers, let your mind move forward a bit to the time when, if a connection-based proposal is adopted, these charges would be assessed by local exchange carriers -- local exchange carriers that do not face effective competition in most markets. I wish it were otherwise.

That is not always a popular thing to hear in Washington, but my clients are in the best position to take advantage of competitive choices. We chew the prospects for competition, but so far, we haven't seen much of it.

We are concerned that if local exchange carriers are also allowed to mark up their Commission assessment rates, whether it's on a connection basis or whether it's on some other basis, it will, in effect, turn into an instance of pricing abuse because there is, so far, not one shred of public data to support the long distance carriers mark ups -- none.

Let's turn, before I run out of time, to Truth in Billing. The Commission's Truth in Billing policies and rules are pretty clear. The charges are supposed to accompanied by clear, non-misleading explanations.

We have a universal connectivity charge. We have a carrier universal service charge. We have a federal universal service fee. Those are the labels from the three largest long distance carriers. I submit that those labels, to the extent that they include significant mark ups, are materially misleading.

They are materially misleading because, for the life of me, and by every good business practice my clients know, no material portion of that large mark up that I have referred to can be traced back to administrative costs or to bad debt.

In conclusion, I ask you to think about this, also. Yes, the universal service program is a federal mandate. However, so also, are workman compensation requirements, OSHA, environmental requirements -- all of those requirements impose costs on businesses. They are not administrative and overhead charges that consumers find in their bills for goods and services as a result of those governmental programs. There should be no mark up in this case either. Thank you.

MS. ABERNATHY: Thank you, Mr. Blaszak.

We're going to make one quick change, Mr. Lubin, because Commissioner Rowe has got to catch a plane, and I want to give him a chance to ask at least one question.

Commissioner Rowe?

MR. ROWE: Thank you very much. I do apologize that I have to head back to Montana.

I want to ask Mr. Sheard a question since he came that distance as well. I was actually surprised by some of the fairly aggressive proposals you made in terms of limiting recovery, the mark up disclosure and other things like that. I wasn't sure if maybe you shouldn't be trading places with Mr. Travieso.

From a perspective of the small business world customers that you work with, what's the reactions currently to bills and anticipated changes in the bills to the additional charges -- things like that?

MR. SHEARD: I'm told that we're getting quite a few complaints every time there is another line item surcharge on there. Of course, we get blamed for it whether we have anything to do with it or not.

I agree it's an effective way to get funding for a lot of good programs, but it's problematic to see that expand, I guess, and we certainly don't want to be thought of gaming that system and making profits on that. I don't think anybody should be able to as well.

MR. ROWE: Thank you.

MS. ABERNATHY: Thank you, Commissioner Rowe.

Mr. Lubin?

MR. LUBIN: Thank you very much. My name is Joel Lubin, Regulatory Vice President, Government Affairs, AT&T.

Thank you for giving me the opportunity to speak at this public meeting on universal service contribution methodology. AT&T fully supports universal service, but the current system is not sustainable. It is not competitively neutral, and it is not customer friendly.

In fact, it is unnecessarily complex, confusing and costly to administer. The simple question -- if the assessment rate is 7.3 percent, why does AT&T have an 11.5 percent collection rate for residential users? I will explain, but I first want to emphasize AT&T is not making a profit on a line item. If it were, we wouldn't be working so hard to fix it.

Let's take an example, assume a carrier has been assessed USF based on $100 million of interstate retail revenues and the USF assessment rate is 7 percent. Therefore, the carrier owes USAC $7 million -- 7 percent of $100 million. Say that carrier is only able to recovery its $7 million from a $50 million revenue base. The carrier would only collect 7 percent of $50 million or $3.5 million. Yet, it must still pay USAC the $7 million.

In order to recovery its four USF obligation from a smaller revenue base, this carrier would need to charge 14 percent of the $50 million to produce the $7 million, which is what the carrier owes USAC. So let's explain why this carrier is assessed $100 million; but, yet, has a recovery base to recover it on of $50 million.

The difference is caused by several things. First and foremost, the six month lag whereby long distance revenues continue to decline between the assessment period and the recovery period because there is a six-month lag. Also, there is a USF assessment on USF revenues, which fortunately will be fixed July 1, 2002.

Another reason is there is uncollectibles. This is due to customers not paying their bills. Finally, we have something called an "unbillable revenues" associated with local exchange carriers who perform the billing function for this carrier. Either the rep refuses to put a USF line item on the bill or they would charge an exorbitant fee for billing it.

Although the FCC has taken a number of steps to ameliorate some of these issues, there are still major flaws with the current system. If the FCC does not undertake much needed changes to the assessment mechanism, I estimate that by the second quarter of 2003, we will see an assessment rate exceeding 9.5 percent. This will no doubt cause a significant increase in my company's USF line item.

I also estimate that the LEC USF line item will rise from the current average of 51 cents per line per month to exceed 75 cent per line per month. The COSAS' plan will eliminate these problems that force a high assessment rate and the disparity between the assessment rate and the recovery rate.

The COSAS' plan has a collect and remit feature, which eliminate the lag and the uncollectible issues such that the carrier remits what he or she collects.

Second, assessing connections minimizes customer confusion, the number of collection points and the number of simultaneous billings necessary to recover the USF assessment from a single customers.

COSAS has one USF charge per residential customer, not two or three as the SBC Bell South or as many as four if a customer also has a dial-around user for international-specific calling points. COSAS eliminates direct billing issues previously discussed because only the carrier with the end user connection would be assessed and recover the USF from the customer.

The COSAS approach minimizes carrier transaction costs. The only mark up that would be required is for a recovery of carrier administrative costs, such as reporting, billing and collecting universal service fees. The mark up should be reflected in an FCC-prescribed safe harbor.

COSAS produces an efficient and sustainable solution to preserve the universal service. The problem with the SBC Bell South plan is that for a given customer, there would be multiple USF line items; thereby, raising transaction costs.

For example, you would have three or four administering USF line items for a single customer, while long distance carriers would have an additional cost because they would need to purchase customer-line information by customer for the residential customer and the business customer.

Under the SBC Bell South treatment of dial-around and pre-paid card services, USAC would have to administer both a connection plan and a revenue-based mechanism, increasing overall costs. What's the bottom line? The current mechanism is broken. It needs to be fixed. We should do everything humanly feasible to fix it by January 2003.

The COSAS' plan reduces the overall USF paid by residential customer wire line users. Today, the average residential customer pays $1.44 versus the COSAS' plan of a dollar. If the current plan is not changed, a few years from now the residential users will be paying in excess of $2 less than a dollar under the COSAS' plan of connections continue to grow as expected. That is to say, the dollar per line will decline in time.

Finally, an observation. Some parties complain that there is a surcharge, and you can't compare one carrier's long distance rates versus another. If, in fact, we go to a connection-based plan, a competitively neutral, equitable and non-discriminatory -- in fact, you will be able to compare plans because there will no longer be a surcharge necessary on the rates, and you will see a truer comparison if that is an issue that concerns parties. Thank you for listening.

MS. ABERNATHY: Thank you very much. Now we will start to my left with questions. I think because of the time, and it's late on a Friday, we'll go with one question per commissioner. Mr. Gregg?

MR. GREGG: Thank you.

Mr. Travieso, Mr. Sheard, Mr. Ednie, as I understand, none of you all support the connection-based proposal or any of the connection-based proposals before us.

If, however, we assume we are going to a connection-based system, what type of recovery system would you support? I'll start with Mr. Travieso.

MR. TRAVIESO: Thank you, Mr. Gregg. The beauty of the NASUCA proposal is that it doesn't depend on the assessment mechanism. So if you decided to change the assessment mechanism, you could assess, based on lines reported to you by companies; but you could still prohibit the companies from assessing the consumer.

So the same result would occur. There would be competition in the marketplace regarding mark up and the efficiency with which companies manage their universal service.

I might point out, I think it's important for regulators to look at other industries -- the electric and gas industries have bad debt. The bad debt is in rates. If they're competitors and they're competing against utilities, they have bad debts as well, and the bad debts are factored into their prices.

So I don't think it's either necessary or appropriate to put these types of costs into a fix surcharge, and it's inconsistent with historical rate-making principles because it's a single item rate-making process, which never gets looked at.

MR. SHEARD: I guess I would recommend that if --

in general, to err on the side of providing the greatest flexibility to the carrier that the carrier can chose to recover the contributions in any way it sees fit.

But if a carrier decides that a line item surcharge is the best way to recover their contributions, it may be warranted to maintain some kind of oversight over that to make sure that's not abused, and that, that information being passed to the consumer is accurate and so forth.

MR. EDNIE: I guess I would be in favor of any system that allowed the carrier a certain amount of flexibility. I would also favor a bill and remit concept within the pass through -- the charge.

As I said earlier, my background is more in the area of tax, and I know the USF is not a tax per say, but there are a lot of similarities to it. In the tax world, we have this concept of bad debt. You're acting as a trustee in the tax world, and you bill a tax and you remit a tax and you don't collect it, you're allowed to take a credit.

They also have very similar concepts to allowing you -- albeit, they're capped, many states allow you to recover some of your administrative costs. When you remit taxes, you will keep 1000 of $100,000 that you billed. So I guess my position would be I would support anything that was flexible. I do believe there are competitive elements to